MEMORANDUM FOR: DCI

The two items on tomorrow's Cabinet agenda deal with domestic political/economic issues. Just to be sure, I checked with [redacted] 25X1
people to make sure [redacted] provide you on the balanced budget item. As serious as our federal deficit is, there does not appear to be [redacted] 25X1

The second item deals with the President's commitment to enact a tuition tax credit bill in the 97th Congress. Please let me know if there is anything that you might think of that we can provide you.

[redacted] 25X1

NSC Review Completed as Redacted.

Date 17 March 1982

FORM 5-75 101 USE PREVIOUS EDITIONS

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ES/MI # 119

17 March 1982

MEMORANDUM FOR: See Distribution

SUBJECT : Meetings

Type of Meeting : Full Cabinet

Date : Thursday, 18 March

Time : 10:45-11:45

Place : Cabinet Room

Chaired By : President

Principal Only? : Yes

Subject/Agenda : (1) Constitutional Balance Budget Amendment
(2) Tuition Tax Credits

When to Expect Papers: Papers will be available at the Situation Room at noon today, Our couriers will pick up.

Time Info Received : Per Patsy, Cabinet Office, 11:25 a.m.

Anne

25X1

THE WHITE HOUSE
WASHINGTON

Executive Registry
82-6152

CABINET AFFAIRS STAFFING MEMORANDUM

MAR 17 24 PM '82

DATE: 3/17/82 NUMBER: 050182CA DUE BY: ER

SUBJECT: FULL CABINET MEETING -- Thursday, March 18, 1982

	ACTION	FYI
ALL CABINET MEMBERS	✓	☐
Vice President	☐	☐
State	☐	☐
Treasury	☐	☐
Defense	☐	☐
Attorney General	☐	☐
Interior	☐	☐
Agriculture	☐	☐
Commerce	☐	☐
Labor	☐	☐
HHS	☐	☐
HUD	☐	☐
Transportation	☐	☐
Energy	☐	☐
Education	☐	☐
Counsellor	☐	☐
OMB	☐	☐
CIA	☐	☐
UN	☐	☐
USTR	☐	☐
CEA	✓	☐
CEQ	☐	☐
OSTP	☐	☐
	☐	☐
	☐	☐

	ACTION	FYI
Baker	☐	☐
Deaver	☐	☐
Anderson	☐	☐
Clark	☐	☐
Darman *(For WH Staffing)*	✓	☐
Jenkins	☐	☐
Gray	☐	☐
Beal	☐	☐
Harper	✓	☐
	☐	☐
	☐	☐
	☐	☐
	☐	☐
	☐	☐
CCNRE/Boggs	☐	☐
CCHR/Carleson	☐	☐
CCCT/Kass	☐	☐
CCFA/McClaughry	☐	☐
CCEA/Porter	☐	☐

REMARKS: The agenda and papers for tomorrow's Cabinet Meeting are attached. The meeting is scheduled for 10:45 AM in the Cabinet Room, with PRINCIPALS ONLY.

NOTE: BECAUSE OF THE SENSITIVITY OF THE SUBJECT MATTER, THE ATTACHED MATERIAL IS BEING DISTRIBUTED TO PRINCIPALS ONLY. ACCORDINGLY, THERE SHOULD BE NO ADDITIONAL CIRCULATION OF THIS MATERIAL.

RETURN TO: Craig L. Fuller
Assistant to the President
for Cabinet Affairs
456-2823

TAB A

CONSTITUTIONAL BALANCED BUDGET

TAX LIMITATION AMENDMENT

(Revised Draft)

Cabinet Council on Economic Affairs

March 17, 1982

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I. Background and Current Status

A. Background

There are two principal objectives behind the "balanced budget" amendment efforts:

- A widespread concern about the rate of growth of Federal spending in relation to the size of the economy.

- A similar concern about persistent budget deficits.

B. Current Status: Call for a Constitutional Convention

- On January 18, 1982, Alaska became the 31st State to pass a resolution calling for a Constitutional convention to draft an amendment requiring a balanced budget.

  Article V of the Constitution requires passage by 34 States before a convention must be called.

- Since some of the resolutions counted among the 31 may be invalid due to a lack of similarity in wording, approval by three more States might not legally require calling a convention. But, should three more States pass resolutions, it would generate significant political pressure to call a convention.

- More likely, Congress will act before the 34-State limit is reached.

C. Current Status: S.J. Res. 58 and H.J. Res. 350

- o There is a resurgence of interest in the Congress in support of a tax limitation-balanced budget amendment, S.J. Res. 58 and H.J. Res. 350.
    - Reportedly, the amendment has picked up about 40 co-sponsors since Christmas, bringing the total to 173 co-sponsors in the House and 67 in the Senate.
    - The bill has been reported out of committee in the Senate, but is not yet scheduled for floor debate. The House is unlikely to act until the Senate has voted.
- o Since the amendment would not go into effect until the second fiscal year beginning after its ratification, it is unlikely that it would take effect until 1986.
- o There is reportedly some discussion among Senate proponents of attaching the amendment to the debt ceiling bill this spring. They argue that this would allow them to demonstrate their concern over the need for a balanced budget at the time they are voting for increasing the debt limit.

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II. Provisions of S.J. Res. 58

A. Principal Features

- o In advance of each fiscal year, Congress would adopt a budget statement under which outlays would not exceed receipts.

- o The annual increase in planned or budgeted receipts over actual receipts would be limited to the rate of growth in national income in the preceding calendar year.

- o As the year progressed, actual receipts would not necessarily equal budgeted receipts, nor would they be required to do so. But actual outlays could not exceed budgeted outlays. If implemented, this would limit the growth in Federal spending to the growth in national income.

- o The Congress and the President would be charged with ensuring that actual outlays do not exceed budgeted outlays.

B. Exceptions

- o In any year, projected outlays could exceed receipts (Congress could plan a deficit) on the vote of three-fifths of the whole membership in each House.

- o The increase in planned tax receipts could exceed the rate of growth of national income by a vote of a majority of the whole membership in each House, and approval by the President.

- o The provisions of the article could be waived for any fiscal year in which a declaration of war is in effect.

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III. Problems and Objections

The various balanced budget or spending limitation amendments to the Constitution drafted in recent years are designed to try to counter what proponents see as incentives built into our system for ever-increasing government spending and deficits. The potential benefits of such an amendment are to:

- o Increase fiscal responsibility; and
- o Limit government spending in relation to the size of the economy.

The following sections of this paper consider the objections or concerns that might be raised with respect to such an amendment, both philosophical and practical, and some possible remedies.

A. Generic Concerns

1) Some are concerned that the Constitution is not an appropriate vehicle for economic policy prescriptions (fiscal norms) nor should it be cluttered with potentially inflexible fiscal mechanisms that may not be appropriate to unforeseeable future circumstances.

2) An inflexible annual balanced budget policy rule may not be compatible with the business cycle "facts of life" which tend to produce automatic, large deficits during recessions. During FY 82, the projected deficit increased by $40 billion due to the recession-induced fall of receipts and the rise of unemployment-related outlays. As drafted, S.J. Res. 58 requires a super majority (60 percent) to agree in advance to a deficit -- yet consensus opinion for several decades has held that recession-induced deficits are either desirable or at least tolerable.

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Since business cycle contractions and expansions are inherent in a free economy, the proposed policy rule would create artificial policy choices and political conflicts on a recurring basis, i.e, whether in the face of a contracting economy to:

- o Raise taxes;
- o Radically reduce spending until recovery raises receipts; or
- o Achieve super-majorities to validate recession deficits.

3) A balanced budget requirement would exacerbate pressure for indirect fiscal spending and other novel budget devices outside the scope of any settled definition of "outlays". While S.J. Res. 58 covers conventional off-budget outlays such as those incurred by the FFB, it would not cover:

- o Loan guarantees ($87.7 billion in FY 82);
- o Schemes to mandate fiscal outlays by private sector entities such as:
  - o Mandatory employer-provided health insurance;
  - o Mandatory employer-provided pension benefits in lieu of Social Security expenditures;
  - o Tax subsidy induced outlays to the extent that leveraging features exceed revenue losses.

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4) Due to the difference in lag-time between policy action and cash impact, an annual balanced budget rule by itself would be, as the framers of S.J. Res. 58 realized, inherently biased toward higher taxes rather than lower spending because:

- o Cash flow changes relating to tax policy can be enacted, implemented and realized in three months (e.g., 5 percent income tax surcharge);
- o In most cases, cash flow changes relating to spending policy require three months to three years to enact, implement and realize -- or even longer.
- o The inherent dynamics of Congress would delay action on the balanced budget rule until close to the applicable fiscal year -- thus steadily strengthening the case for a tax increase rather than spending cut solutions to comply with the balanced budget rule.

B. Concerns Specific to S.J. Res. 58

5) S. J. Res. 58 seeks to overcome this inherent bias by merging a balanced budget rule with a tax limitation rule. However, the specific tax limitation rule (no automatic increase in taxes in excess of the previous year's growth in national income) would have a limiting effect only in the case of an un-indexed tax system. This is shown by comparing the applicable revenue increase/national income relationships for the late 1970's and prospectively for the 1980's when indexing takes effect:

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Old Tax Law	FY 76	FY 77	FY 78	FY 79	FY 80	Average Annual Growth Rate
	(percent change)[1/]					
Actual receipts................	6.8	15.2	12.4	16.0	11.6	12.5
Base year GNP[2/]................	8.1	8.0	10.9	11.6	12.4	10.2
Current Tax Law - ERTA	**FY 83**	**FY 84**	**FY 85**	**FY 86**	**FY 87**	**Average Annual Growth Rate**
Projected current law receipts..	4.3	7.7	10.0	8.4	7.5	7.6
Projected base year GNP[2/].......	11.5	7.9	11.5	10.2	9.7	10.2

1/ Annual rate of growth.

2/ The base year GNP growth rate under S. J. Res 58 is the growth in GNP during the preceding calendar year. For fiscal year 1983, for example, the receipt growth would be limited to the rate of growth in GNP (or some other measure of national income) during calendar year 1981.

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The tax limitation rule proposed in S.J. Res. 58 is comparable to shifting indexing from the IRS code to the Constitution.

6) The tax limitation and balanced budget rules in S.J. Res 58 are seriously asymmetrical:

- o Deficit creation or increases require a super-majority (60 percent) of the full body;
- o Tax raising requires only an ordinary majority of the full body.

Consequently, a 41 percent minority for tax raising will have Constitutionally granted parliamentary superiority over a 59 percent majority favoring some combination of spending cuts and/or deficits.

7) Given the current uncontrollability of spending for many income support programs, S.J. Res. 58 could have, but would not necessarily have, a bias against defense. By FY 86, defense outlays will account for $311 billion of projected total controllable outlays of $442 billion (excluding undistributed offsetting receipts) or 70 percent. If entitlements were not cut, the 47 percent share of controllable outlays would be the first target if outlay reductions were required to achieve the balanced budget rule or enforce the outlay ceiling within the single fiscal year time frame called for by the amendment.

8) Differences in the budget and economic outlook between the initial submission of the President's budget and the actual fiscal year results have been substantial in recent years. Once the budget year has started, offsetting outlay increases attributable to economic factors or volatile accounts -- such as the Commodity Credit Corporation, Farmers Home Administration, insurance funds such as FSLIC, grant payment mechanisms like the Departmental Federal Assistance Financing System -- would require draconian program cuts. This is illustrated in Appendix A. In fact, uncontrollables and prior-year commitments make it extremely difficult to counteract outlay overruns within a fiscal year, whatever the reason for them.

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IV. Remedial Suggestions

There are several possible alternatives for modifying S.J. Res. 58 that could help address these concerns. They fall into three main groups: (1) measures to ease the problems and consequences of controlling outlays within a given fiscal year; (2) measures to redress the asymmetry between enacting tax increases and permitting deficits; and (3) measures which would increase the enforceability of the amendment by enhancing the President's ability to control outlays.

A. Controlling Outlays Within a Given Fiscal Year.

The purpose of the balanced budget amendment is to impose discipline on the legislative and executive branches with regard to discretionary policy actions. Certain government outlays are not discretionary and can vary substantially depending on economic conditions which are difficult to forecast with precision. A classic and recurring example is interest payments on the Federal government's debt. There are a number of alternative ways of permitting some relief for such circumstances while maintaining discipline with regard to discretionary policy actions.

1) Permitting an ordinary majority of both Houses to increase the outlay ceiling for interest payments on the national debt in excess of that estimated in the statement of outlays.

2) A second, broader option would provide an escape clause for outlay overruns attributable to unforeseen economic changes (e.g. higher interest rates, higher unemployment, changes in oil prices or crop forecasts).

3) A third approach would allow modest flexibility in any single fiscal year by permitting a small percentage overrun in actual outlays over budgeted outlays.

4) A fourth approach would permit multi-year budgeting by allowing balancing the budget over a time period longer than one fiscal year. In this instance, a deficit in one year could be carried forward and offset by surpluses in one of the next two years.

5) Finally, the amendment could be modified to include a clause providing for implementing legislation:

> "The Congress is authorized to provide for the faithful and flexible implementation of this amendment through such legislation as may be necessary."

B. <u>Asymmetry Between Increasing Taxes and Permitting Deficits</u>

S.J. Res. 58, as currently drafted, makes tax increases rather than spending cuts -- the more likely vehicle for balancing the budget over time.

Increasing planned tax receipts in excess of the rate of growth of national income would require an ordinary majority of the whole membership in each House. Once tax receipts were increased in a single year, the base for calculating allowable tax receipts for future years would increase as well. This would provide a powerful incentive for those desiring higher future levels of spending to support increased taxes.

Allowing outlays to exceed receipts, with the resulting deficit, however, would require three-fifths of the full membership in each House. When a deficit is permitted in one year, the base for calculating allowable receipts and outlays in future years remains unaffected.

Thus, the asymmetry between the percentages required for enacting tax increases and allowing deficits would probably result in higher spending, in the long-run, than if both tax increases and deficits required the same percentage in each House.

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There are three basic alternatives for rectifying this asymmetry:

1) Require 60 percent of the whole membership of each House for increasing taxes as well as for permitting a deficit.

2) Require 60 percent of those present and voting in both Houses for either a tax increase or a deficit.

3) Require a 50 percent majority of the whole membership of both Houses for both tax increases and deficits.

C. Line Item Veto

The value of a balanced budget-tax limitation amendment depends in the end on the capacity to enforce it. Providing the President with line item veto authority would more clearly focus responsibility for the rate of growth in Federal spending. There is ample precedent and widespread acceptance of this approach to controlling spending in State constitutions.

- o Presently, 43 State Governors have line item veto powers.

- o In addition, Governors in 13 States can reduce the amounts in line items in appropriations bills.

- o The Governor of Wisconsin can even veto language as well as money in appropriations bills.

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D) Statutory Implementation Tools

Establishing outlay control measures can occur through statutory as well as constitutional changes. A package of statutory implementation tools to enhance the Federal government's capability for dealing with the requirements of S.J. Res. 58 might include:

1) Presidential powers to suspend or limit indexed benefit increases modeled after the current method for determining Federal pay increases;

2) Enhanced Presidential rescission powers with a two-House veto;

3) Establishing an Independent Budget Concepts Commission to help ensure that the amendment is not circumvented through off-budget techniques. The commission could issue non-binding opinions, similar to the accounting standards issued by the Financial Accounting Standards Board (FASB) in the private sector;

4) Changing civil service procedures to provide greater flexibility in reducing the size of the Federal workforce.

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Appendix A

Changes in economic conditions after the original budget submission can affect outlays for interest, unemployment insurance, and other programs dramatically beyond the point where compensating outlay reductions can be easily identified.

Increase in Outlays From the Initial Budget Submission Due to Changed Economic Factors (In Billions of Dollars)

FY 80 (actual)	27.1
FY 81 (actual)	32.3
FY 82 (estimated)	25.9

- After even one quarter of the fiscal year has elapsed, the following annual rates of program reduction are needed (on average) to achieve a $10 billion reduction in current year outlays from controllable programs.

	Outlay Cut (B.A.)	Program Cut (B.A.)	Ratio
Defense	$10	$33	3.3:1
Defense (excluding military pay)	$10	$40	4.0:1
Non-defense	$10	$30	3.0:1

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- The table below illustrates that as the year progresses, increasingly more drastic program cuts are needed to achieve fixed outlay reductions.

Illustrative
$10 Billion Reduction in
Discretionary Programs 1/
(In Billions of Dollars)

	Beginning of Year	1/4 of Year Gone	1/2 of Year Gone	Total Outlays
National Defense				
Controllable outlays 2/..........	117.4	88.0	58.7	182.8
Percent of controllable outlays affected by $10 billion cut......	8.5%	11.4%	17.0%	N.A.
Budget Authority deferred or rescinded associated with $10 billion outlay cuts..........	17.4	28.9	52.0	N.A.
Civilian Programs				
Controllable outlays 2/...........	71.5	53.6	35.7	542.5
Percent of controllable outlays affected by $10 billion cut.......	14.0%	18.7%	28.0%	N.A.
Budget authority deferred or rescinded associated with $10 billion outlay cut...........	14.1	24.1	43.4	N.A.

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In the real world, there is probably no way to rationally enforce an S.J. Res. 58 type outlay limit if actual fiscal year outlays exceed planned ceiling outlays to any appreciable extent. For instance, if the $695 billion outlay ceiling voted for FY 82 is taken as a test case, the January re-estimate of $729.3 billion would present the following choices and options:

Outlay Reductions Necessary	1982
Estimated FY 82 outlays	729.0
Resolution outlay ceiling for FY 82	695.0
Outlay reduction necessary	34.3
To achieve necessary outlay reductions:	
Start from estimated FY 82 outlays, 2nd-4th quarter	535.1
Exclude from candidate list of possible outlay reductions:	
a) Debt service requirements	62.5
b) Outlays from prior year obligations	90.2
c) UI compensation	21.2
d) CCC -- dollars already out the door	5.1
e) IRS on the grounds that massive RIFs would cause a revenue hemorrage	
f) Veterans hospital funding on the basis of the impact of cutting in such a personnel-intensive operation	8.0
g) Payments for Federal prisons	
h) FAA air traffic control (again a personnel intensive operation)	
Subtotal, items that must be excluded from candidate list of possible outlay reductions	187.0
Remaining "available" outlays for reduction	348.1

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<u>Policy Iterations to Achieve Reductions</u> (48% of estimated total FY 82 spending):

	1982
a) Cancel general revenue payments beginning the 2nd quarter	3.4
b) Freeze all benefit indexes for the remainder of the year	5.1
c) Medicare -- limit the annualized level to three fourths of the increase from 1981 to estimated 1982	1.8
d) Medicaid -- limit the annualized level to three-fourths of the increase from 1981 to estimated 1982	0.2
Subtotal	10.5
Remaining reductions needed	23.8
Remaining "available" outlays for reduction (gross of offsetting receipts)	156.8
Defense	-92.4
Nondefense	-64.4
Pro-rated 15.2% reduction in remaining outlays:	
Defense	14.0
Nondefense	9.9

<u>Illustrative Impacts</u>:

- o Revenue sharing accounts for <u>43 percent</u> of total revenue in Arkansas;
- o Disruption of hospital cash flow (Medicare) could cause massive shut-downs;
- o Dollar defense program cuts (TOA) of $46 billion would be needed resulting in grounding of ships, planes, and most other operations;
- o Approximately 200,000 or about 18 percent of the Federal non-defense workforce would be furloughed;
- o Most defense and civilian procurement and capital spending projects (highways, water projects, etc) would be suspended or drastically reduced.

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